



CANADIAN FINANCE & LEASING ASSOCIATION
ASSOCIATION CANADIENNE DE FINANCEMENT ET DE LOCATION

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Original by courier

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The Honourable John Manley, P.C.M.P.
Deputy Prime Minister & Minister of Finance
L'Esplanade Laurier
21st Floor, East Tower
140 O'Connor Street
Ottawa, ON
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Re: CFLA Recommendations for Canada's 2003 Budget

Minister,

The Canadian Finance & Leasing Association (CFLA) represents the asset-based financing, equipment and vehicle leasing industry in Canada. A list of our 230 members is attached to this letter. Today, we estimate this industry to have a total of over \$100 billion in financing in place across Canada. The majority of the industry's customers are small and medium-sized businesses and consumers. As you know, leasing provides financing for a wide variety of assets, ranging from personal computers and office equipment to light and heavy vehicles and machinery.

The government's stated policy objectives of reducing taxes, encouraging innovation, fostering a climate for Canadian business in which they can effectively compete globally, increasing both our productivity and access to financing, creating jobs, and sound fiscal management are certainly positions that our members support. CFLA members provide substantial financing in support of the prosperity and growth of Canada's small and medium sized businesses.

Where small and medium sized businesses do not qualify for financing with traditional financing sources, our members, by way of leasing, make it possible for them to acquire equipment and vehicles to the enhancement of their businesses and their productivity.

After the traditional lenders (banks and credit unions), the asset-based financing and leasing industry is the most important supplier of financing to Canadians. Today, all Canadians enjoy the benefits of having a vibrant asset-based financing and leasing industry – including direct and indirect job creation, taxation benefits to the Crown (individually and corporate), and the dynamic synergy created by having these members compete and contribute to Canada's financial services sector.

By facilitating the acquisition of productive assets by Canadian businesses and consumers, the asset-based financing industry is helping Canada work smarter. Leasing provides a flexible means for businesses to respond on a timely basis to the productivity and competitive challenges of technological obsolescence and product innovation. The key to raising the standard of living of Canadians is to work more productively. Our industry is an essential member of the national productivity partnership.

Improving our Productivity

CFLA recommends a two-pronged approach to the acquisition and effective deployment of new equipment to enhance productivity: the elimination of the Large Corporations Tax (LCT) and expanding innovative investment in human capital.

Eliminating the Large Corporations Tax (LCT)

“Some will wonder what to expect from me. In part, this is simple: a continuing and determined commitment to balanced budgets and a declining debt burden, while Canadians continue to see their tax load decline.”

Statement by the Honourable John Manley, Deputy Prime Minister and Minister of Finance, to the House of Commons Standing Committee on Finance, Ottawa, June 19, 2002.

As you identified in your statement to the House of Commons Standing Committee on Finance in June, 2002, lower taxes are a priority for Canadians because: “these reductions will enhance incentives to invest and create jobs in this country.” We applaud the efforts and progress that your government has made towards reducing the tax burden.

We are encouraged by your observation that, *“in 2001 alone our tax cuts pumped \$17 billion into our economy, supporting Canadian economic growth.”* We know that you will continue to pursue an aggressive tax reduction plan, because tax cuts work. Recent studies have demonstrated that Ireland, for example, has surpassed Canada’s GDP growth, because of the aggressive measures taken by their government to reduce taxes on business. If Canada is to effectively compete not only in a North American economy, but also in a global economy, our productivity and investment attractiveness can only be gained with complimentary taxation policies.

There appears to be a broad consensus that the Large Corporations Tax at the federal level and capital taxes at the provincial level should be eliminated as a drag on economic development. Your colleague, the Secretary of State for International Financial Institutions, former Chair of the Standing Committee on Finance, the Hon. Maurizio Bevilacqua, P.C. M.P., has said that, *“capital taxes are a tax on innovation, productivity, on investment and ultimately on jobs.”*

The LCT and provincial capital taxes add noticeable costs to businesses acquiring the use of productive assets by way of leasing transactions. Furthermore, the longer the term of the lease, the higher the combined LCT and provincial cost impact on a transaction.

By way of example, the combined LCT and provincial capital tax (in Ontario) may be 0.525% but,

- The LCT and Ontario capital tax add 0.94% to the total transaction cost for a customer on a \$25,000 48-month computer equipment lease. This additional cost reflects the cumulative LCT and capital tax cost of the average asset value over the lease term. This additional cost alone increases the customer's lease rate by 0.48%.
- The cumulative LCT and Ontario capital tax cost for the lease of a \$2 million Magnetic Resonance Imaging (MRI) machine leased over 10 years is 2.49% of the total transaction cost.
- When it comes to the long-term leasing of a \$20 million commercial aircraft, the combined LCT and Ontario capital tax adds 4.24% to the total customer transaction cost.

There is general agreement that the elimination of capital taxes will advance the twin national goals of achieving increased productivity and a better standard of living for all Canadians.

The CFLA urges the federal government to immediately eliminate the federal Large Corporations Tax as an important step in fostering innovation, job creation, and productivity.

Expanding investment in innovative human capital

The second part of our proposed two-pronged approach is expanding investment in innovative human capital.

We are concerned that Small and Medium-sized Enterprises (SMEs) are often deterred from investing in new productive equipment and technology because they cannot afford the soft costs that are required— such as installation/ implementation, employee skills training, upgrading, and trouble-shooting— plus the time needed to understand how the new technologies work. Although a study of a specific business sector, a recent article in the RAND Journal of Economics entitled “Noncapital Investment Costs and the Adoption of computer aided-design (CAD) and computer numerically controlled (CNC) machine tools in U.S. metal working industries,¹” confirms this challenge.

The study refers to measures taken by the U.S. federal government over the last 20 years to encourage business investment and broaden access to training, to successfully foster the adoption of new technology and equipment that has ultimately improved productivity. The reported result was more SMEs invested in new technology and equipment early on. Consequently, they became more productive and efficient. To our knowledge, there are no similar federally-supported programs available to manufacturers in Canada.

¹ Thomas Astebro, “Noncapital investment costs and the adoption of CAD and CNC in U.S. metalworking industries”, RAND JOURNAL OF ECONOMICS, VOL 33, No. 4, Winter 2002, pp.672-688.

For most SMEs, the effort and cost of integration of new technology and equipment are a significant factor in the business decision whether or not to acquire the new technology and equipment in the first place. If the government is serious about assisting SMEs acquire innovative technologies and equipment, policy cannot forget the hurdles of implementation.

CFLA members recommend the Federal government immediately introduce taxation based incentive measures for business that support investment in innovative human capital.

Revised Capital Cost Allowance (CCA)

"We cannot win in today's global economy by settling for second best or what was best a decade ago—or, in some cases, even what was best last year. We must focus on areas that will give us an edge in the global economy. This, in turn, means we must be ready to challenge traditional assumptions, reconsider old ideas and, above all, make the changes needed to succeed."

Statement by the Honourable John Manley, Deputy Prime Minister and Minister of Finance, to the House of Commons Standing Committee on Finance, Ottawa, June 19, 2002.

An overall review of the present Capital Cost Allowance (CCA) structure and rates is needed, but specifically there is an immediate need for a review in terms of information technology equipment. Present CCA rates are not in step with the rapid rate at which technology is advancing. All should be able to agree that CCA rates should accurately reflect asset depreciation. If they fail to do so, business decisions become distorted by the tax system.

Currently, the "separate class" rules do provide some relief on disposition, but they do not provide for deductions that accurately reflect the depreciation of the equipment while it is in productive use.

Furthermore, a November 2000 Conference Board of Canada report strongly demonstrated the link between investment in information technology and increased productivity. Accelerating the rate at which CCA can be deducted for income tax purposes would encourage investment of this nature, and the resulting productivity gains would serve to increase the global competitiveness of Canadian companies.

Measures to enhance the deductibility of information technology equipment have recently been implemented in the United States where a bonus depreciation allowance of 30 percent is being allowed in addition to the usual annual depreciation.

We recommend that information technology equipment worth up to \$5000 would be deductible in the year of acquisition. Purchases above this amount should form part of a newly created class of assets, with a 50% CCA rate, along with continuation of the present "separate class" rules.

Elimination of withholding taxes on interest and dividends

Recent studies, such as one released by the C.D. Howe Institute, have shown a strong link between increased foreign direct investment and the elimination of withholding tax on interest and dividends. The C.D. Howe Institute's report² provides information demonstrating the benefits that Canada would realize by eliminating the present withholding tax on interest and dividends (for both related and non related parties) on payments made to US parties.

This report claims that elimination of withholding on dividends and interest would result in an increase in capital investment in Canada of approximately \$28 billion, and an increase in income of over \$7.5 billion annually. The report also summarizes the main impacts on Canada, arising from our levying these withholding taxes which include their negatively impacting the free flow of capital, acting as a deterrent to foreign direct investment in Canada, and interfering with the efficiency of a global operation.

For these reasons, we recommend that a long-term strategy be developed in an effort to phase-out withholding taxes on interest and dividends (both related and non-related parties). Studies, such as the one prepared by the C.D. Howe Institute have shown a strong link between increased foreign direct investment and the elimination of withholding tax on interest and dividends. This is specifically relevant in terms of the Canada--US Treaty.

Again, we re-iterate our support for the commitments and efforts that your government has made towards reducing taxes, encouraging innovation, fostering a climate for Canadian business in which they can effectively compete globally, increasing both our productivity and access to financing, creating jobs, and fiscal management. We are hopeful that you will continue to pursue an aggressive tax reduction plan, similar to that of our biggest trading partner and competitor, the United States, because tax cuts work.

Like the government, we seek solutions and we are always willing to work in partnership with you to find solutions so that Canada can continue to be a premier engine driving the global economic landscape.

Yours very truly,



David Powell
President & Chief Executive Officer

Enclosures: membership list

Copies:

The Right Hon. Jean Chrétien, P.C.M.P.

The Honourable Maurizio Bevilacqua, P.C.M.P., Secretary of State (International Financial Institutions)

Aimee Sulliman, Director, Policy & Planning, CFLA

² Jack M. Mintz, "Withholding Taxes on Income Paid to Nonresidents: Removing A Canadian-US Border Irritant," C.D. Howe Institute Backgrounder, March 5, 2001.